

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 97-0500
STATE GROSS RETAIL AND USE TAX
For the Tax Years 1988 through 1996**

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ISSUES

I. Calculation and Imposition of the State Gross Retail Tax and Use.

Authority: IC 6-2.5-2-1; IC 6-2.5-4-1(b); IC 6-2.5-9-3; IC 6-8-5-1; 45 IAC 2.2-3-20; 45 IAC 2.2-4-2.

Taxpayer protests the Department's decision to impose liability for unpaid sales and use taxes on transactions involving the production of videotaped materials. The taxpayer sets forth two arguments. Taxpayer maintains that it operates a service business and should not be collecting sales tax. Taxpayer maintains that the method used by the auditor to extrapolate the taxpayer's tax liabilities, based upon the taxpayer's limited business records, was inaccurate.

II. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2(c).

Taxpayer argues that the Department should exercise its discretionary authority to abate the ten-percent negligence penalty. Taxpayer argues that it did not consciously attempt to avoid its tax liabilities, but that taxpayer acted upon the erroneous advice of a former CPA in deciding not to charge customers sales taxes or to self-assess use taxes.

STATEMENT OF FACTS

Taxpayer operates a business in which customers bring motion picture film, slides, and photographs for the purpose of transferring those materials to videotape. Additionally, the taxpayer provides its customers videotape editing and videotape duplication services. During the tax years at issue, the taxpayer was not registered to collect sales taxes. Department Form AD-40, p. 11. Nonetheless, on certain transactions the taxpayer chose to collect sales tax. Id. The auditor determined that transactions involving the duplication

of videotapes were subject to the imposition of the state sales tax. Because the taxpayer was unable or unwilling to provide more complete records, the auditor employed a projection method to determine the taxpayer's sales tax liability. Because the taxpayer's 1996 records were the most complete, the auditor selected 1996 as the base year from which to extrapolate liabilities for 1988 through 1995. The auditor employed a similar methodology to determine the taxpayer's use tax liability but chose 1995 as the base year.

DISCUSSION

I. Calculation and Imposition of the State Gross Retail Tax and Use Tax.

A. Applicability of Gross Retail Tax.

Under IC 6-2.5-2-1, Indiana imposes a gross retail (sales) tax on retail transactions made within the state. A retail transaction, the pre-requisite to the imposition of the tax, is the transfer, in the ordinary course of business, of tangible personal property for consideration. IC 6-2.5-4-1(b). 45 IAC 2.2-4-2 describes those situations in which a service provider, such as the taxpayer, conducting transactions involving the transfer of tangible personal property, is liable for sales tax on those transactions. The regulation states that "[w]here, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail" 45 IAC 2.2-4-2(a).

Distinguished from those transactions in which taxpayer transfers various media to videotape or edits videotaped information, taxpayer also provides videotape duplication services. In these transactions, taxpayer creates multiple copies of pre-recorded and pre-formatted videotape cassettes. These transactions are subject to the state's gross retail tax because the customer's primary objective is the receipt of an end product consisting of tangible personal property. The taxpayer's duplication of videotapes is analogous to the duplication of photographic prints described in Information Bulletin # 34. That bulletin states that, "In making additional photographic prints from an original negative or photograph, the photographer is producing and selling tangible personal property and the [sales] tax applies to the selling price of the prints" Undoubtedly, a certain skill and knowledge is involved in duplicating either photographic prints or videotape cassettes. However, the objective of either duplicating photographic prints or videotape cassettes is the transfer of tangible personal property. Accordingly, the state's gross retail tax is applicable to those transactions in which the objective of the transaction is the production of copies of videotape cassettes.

B. State Use Tax.

Having found that certain of the taxpayer's transactions are not subject to the state's gross retail tax by virtue of 45 IAC 2.2-4-2(a)(3), taxpayer necessarily falls within the associated limitation imposed by 45 IAC 2.2-4-2(a)(4). That regulation requires that

taxpayer “pay[] gross retail tax or use tax upon the tangible personal property at the time of acquisition.” IAC 2.2-4-2(a)(4). Therefore, for service transactions in which taxpayer transfers various media to videotape or edits videotape information – for which taxpayer is not responsible for collecting sales tax – taxpayer is responsible for self-assessing use tax against tangible personal property purchased to effectuate those transactions and for which taxpayer did not initially pay sales tax. In addition, the original audit determined that taxpayer, pursuant to 45 IAC 2.2-3-20, was subject to the imposition of use taxes on purchases of personal property stored, used, or consumed in Indiana. Taxpayer does not contest the applicability of the use taxes generally but does aver as to those transactions conducted at large retail establishments where – as taxpayer contends – it was unlikely that taxpayer failed to pay the initial sales tax. However, where taxpayer is unable to substantiate its assertions concerning specific transactions, taxpayer is unable to overcome the presumption of correctness afforded the original audit under IC 6-8-5-1. That statutory provision states that “[i]f the department reasonably believes [the taxpayer] has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department.” IC 6-8-5-1(a). Once the Department makes a “best information available” assessment, the “proposed assessment is prima facie evidence that the department’s claim for the unpaid tax is valid.” IC 6-8-5-1(b).

C. Audit’s Projection Methodology.

For the tax years 1988 through 1995, because taxpayer’s financial records were incomplete, the audit employed a projection method to determine taxpayer’s sales tax liability. Department Form AD-40, p. 11. The audit used 1996 as the basis for making that projection. Taxpayer has prepared and presented an alternative basis for determining its 1988 through 1995 liabilities. In this alternative projection, taxpayer has assembled financial records for 1996 through 1999 and used those years to extrapolate the absent 1988 through 1995 records. Taxpayer asserts that the original sales tax assessment should be abandoned, be replaced with taxpayer’s alternative calculation, and that its 1988 through 1995 sales tax be recalculated.

Under IC 6-8.1-5-1(b), the original audit determination, based upon the best information then available and under the authority of IC 6-8.1-5-1(a), is presumed valid and taxpayer bears the burden “of proving that the proposed assessment is wrong” Taxpayer fails to meet that statutory burden. In effect, taxpayer has proposed an alternative calculation of its sales tax liability. However, no matter how well prepared and carefully calculated that proposed alternative may be, taxpayer has failed to demonstrate that audit’s original projection – based entirely on taxpayer’s own 1996 records – is erroneous. Taxpayer has failed to meet its burden of “*proving* that the proposed assessment is wrong” IC 6-8.1-5-1(b).

D. Sales Taxes Collected by Taxpayer.

Information provided within the original audit indicates that taxpayer unilaterally chose to collect sales taxes prior to the time taxpayer was registered, authorized, or required to

do so. Department Form AD-40, p. 11. Setting aside the otherwise indelicate legal issues raised by that decision, taxpayer remains personally liable to the state for sales taxes it collected. IC 6-2.5-9-3 provides that taxpayer, having collected sales taxes, “holds those taxes in trust for the state and is personally liable for the payment of those taxes, *plus any penalties and interest attributable to those taxes*, to the state.” IC 6-2.5-9-3 (Emphasis added).

FINDING

Taxpayer’s protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer asks the Department to exercise its discretionary authority to abate the ten-percent negligence penalty assessed pursuant to IC 6-8.1-10-2.1. Taxpayer sets forth five arguments: taxpayer operates a small business; the taxpayer received incorrect tax advice; the taxpayer was undergoing its first audit; the taxpayer did not intend to avoid its tax liabilities; and the taxpayer was not negligent in its actions. Under IC 6-8.1-10-2.1(d), the Department is empowered to waive the ten-percent negligence penalty if the taxpayer can establish that failure to pay the deficiency was due to reasonable cause and not due to willful neglect. Under 45 IAC 15-11-2(c), in order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. Ignorance of the listed tax laws, rules, and/or regulations is treated as negligence.

Factors which may be considered to determine reasonable cause include the nature of the tax involved, judicial precedents set by Indiana courts, judicial precedents established by jurisdictions outside Indiana, published department instructions, information bulletins, letters of findings, rulings, and letters of advice. 45 IAC 15-11-2(c).

It is apparent from taxpayer’s various arguments that it is unable to establish a “reasonable cause” for its failure to properly self-assess use taxes or to justify a decision to randomly collect sales taxes prior to the time taxpayer was authorized to do so. Taxpayer can offer no substantive rationale to justify the methodology employed in determining its state tax liability. Taxpayer can point to no precedents, instructions, bulletins, statutes, or regulations which would have rationally led taxpayer to arrive at the decisions it reached.

FINDING

Taxpayer’s protest is denied.